

The State Bar of California

Client Security Fund - 2007 Activities Report

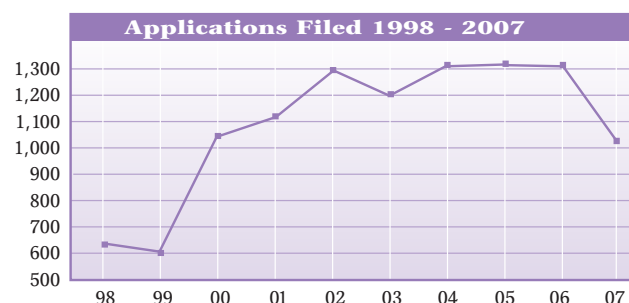
Public Protection Program

The Client Security Fund, established by bar-sponsored legislation in 1972, represents one of the State Bar's major efforts to achieve its public protection goals. In addition to disciplinary procedures, as part of the Bar's public service, the Fund helps to alleviate injury to legal consumers who sustain money or property loss as the result of dishonest conduct by a member of the Bar. The Fund is designed to reimburse victims who have lost money or property due to theft, or an act equivalent to theft, committed by a lawyer acting in a professional capacity.

The Fund provides the legal profession with a unique opportunity to promote public confidence in the administration of justice and the integrity of the legal profession. It is also a cost-effective way of providing reimbursement to victims that is generally not available from any other source. The Client Security Fund works closely and cooperatively with the State Bar's lawyer discipline system and the State Bar Court to achieve the Fund's objectives--to come to the aid of those clients who have suffered a loss caused by a diminutive number of errant lawyers.

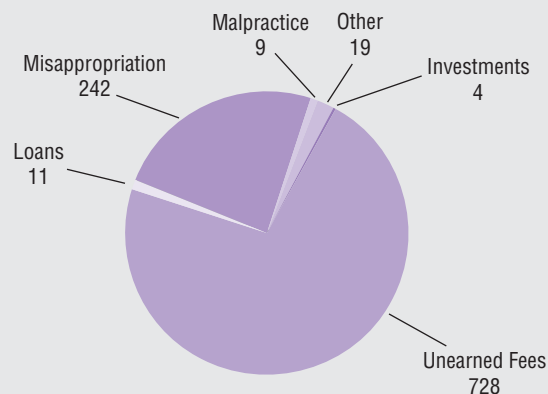
Financed in 2007 by a \$40 annual assessment added to the membership dues paid by California active lawyers and a \$10 annual assessment paid by inactive lawyers, the Fund reimburses eligible applicants up to a \$50,000 maximum payment. However, there is no limitation on the aggregate amount paid against a Respondent attorney. Since its inception, the Fund has reimbursed applicants approximately \$85 million. In 2007, the Fund paid \$4,352,110 on 607 awards against 156 lawyers. The most typical losses reported are theft of client personal injury settlement funds and the refusal to refund fees when the lawyer performs no work.

In 2007, the Fund received 1,013 new applications. As the chart below reflects, the filing rate for new applications was significant lower than usual in 1998-1999 due to the virtual shutdown of the discipline system during a fee bill crisis (i.e. June 1998 through March 1999). However, since the year 2000, the filing rates for new applications have continued to rise.



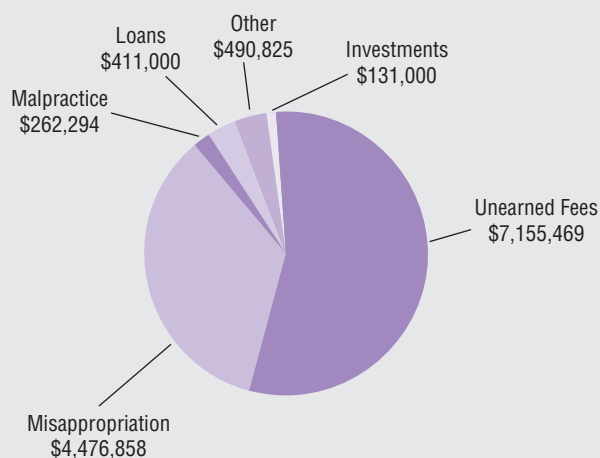
Number of Applications Filed by Category in 2007 Total: 1,013

The largest number of applications filed was in the "unearned fees" category (71.9%). The second largest number of applications filed was in the "misappropriation" category (23.9%).



Dollar Amount of Applications Filed by Category in 2007 Total: \$12,927,446

"Unearned fees" cases comprised the largest number of applications filed representing approximately 55.4 percent of all dollar losses reported. "Misappropriation" cases comprised the second largest number of applications filed represented approximately 34.6 percent of all losses reported.



"This program has been an immense assistance to myself and family. My praises to you and your department."

(Quote from Applicant 2007)

Legislation

Oversight of the Client Security Fund is provided by the Legislature through a series of statutes, and by the Bar's Board of Governors through the Rules of Procedure, Client Security Fund Matters.

The State Bar's authority to operate the Client Security Fund is found in Business & Professions Code section 6140.5. This Legislation, effective March 4, 1972, was a result of a Board resolution dated June 17, 1971 and a Bar-sponsored bill. Section 6140.5(a) requires the Board to maintain a Client Security Fund.

Effective January 1, 2006, Section 6140.5(a) was amended to expand the purpose of the Client Security Fund to include relieving or mitigating pecuniary losses caused by the dishonest conduct of Foreign Legal Consultants registered with the State Bar and attorneys registered with the State Bar under the Multi-jurisdictional Practice Program.

Section 6140.5(b) provides a special statute of limitations whereby the Bar may bring an action to enforce its subrogation rights within three years of the date of payment to an applicant. Another part of the Bar's effort to collect against the errant lawyer is section 6140.5(c) which allows the Bar to add any CSF payout, plus interest and processing costs, to the membership dues bill of any lawyer who has been disciplined or resigns with discipline matters pending and seeks to be reinstated.

Section 6140.5(d) allows certain fund payments to be enforced as money judgments pursuant to Division 2 (commencing with Section 695.010) of the Code of Civil Procedure. This subdivision does not limit the power of the Supreme Court to alter the amount owed or to authorize the State Bar Court, in the enforcement of a judgment under this subdivision, to approve an agreement for the compromise of that judgment.

Section 6140.55 currently allows the Board to assess annually up to \$40 per active member and \$10 per inactive member to support the Fund. This assessment is to be used only for the purposes of the Fund.

Section 6149.5 serves as an early loss prevention measure. It requires insurers to provide written notice to a claimant of settlement payments of \$100 or more delivered to the claimant's lawyer or other representative in settlement of any third-party liability claim.

Another statute that affects the Fund is section 473 of the Code of Civil Procedure. Under this section, when a court sets aside a default judgment due to a party or attorney's mistake, inadvertence, surprise or excusable neglect, it may (1) impose a penalty of no more than \$1,000, (2) direct the offending attorney to pay up to \$1,000 to the Client Security Fund, or (3) grant such other relief as appropriate. Under this statute, the Fund received \$17,450 in 2007.

Rules and Coverage

The Fund is governed by the Rules of Procedure, Client Security Fund Matters which were adopted by the Board of Governors on December 21, 1985. Under these Rules, a seven-member Commission, appointed by the Board, acts as the Board's delegate in administering the Fund. From time to time, the Commission recommends to the Board amendments to the Rules of Procedure. Proposed rule changes are circulated for public comment before final action is taken by the Board.

The rules set forth the scope and purpose of the Fund, the authority of the Commission, the requirements for reimbursement, the application process, the confidentiality of the Fund records, and judicial review of Commission decisions. An applicant or Respondent lawyer may seek judicial review of a Final Decision of the Commission in the superior courts of the State under section 1094.5 of the Code of Civil Procedure.

General Basis for Reimbursement

An applicant must establish the loss of money or property which came into the hands of an active member of the State Bar while acting as a lawyer, trustee or fiduciary as defined in the Rules of Procedure, Client Security Fund Matters, and which loss was caused by a dishonest act as defined under the rules.

Rule of Limitations

Applications for reimbursement from the Fund must be filed within four years after the applicant discovers or reasonably should have discovered the loss.

Status of the Lawyer

In order for reimbursement to be paid, the lawyer whose dishonest conduct caused the loss must have been acting as a lawyer, or in a specified fiduciary capacity, such as the trustee of an express trust or as an escrow holder.

Also, the lawyer must have been disciplined, voluntarily resigned, died, been found mentally incompetent or been judged guilty of a crime that involved the loss. The Rules do give the Commission the discretion to waive this requirement under certain limited circumstances - for example, in clear cases when formal charges have been filed but the lawyer has not yet been disciplined.

Dishonest Conduct

A lawyer's dishonest conduct that can lead to payment from the Fund includes:

- theft or embezzlement of money or the wrongful taking or conversion of money or property;
- refusal to refund unearned fees received in advance where the lawyer performed no services or an insignificant part of the services contracted for such that the lawyer can be regarded as having lacked the intention to perform at the time payment was received;
- the borrowing of money from a client without the intention or the reasonably anticipated ability to repay it;
- obtaining money or property from a client by representing that it would be used for investment purposes when no investment is made; or
- an act of intentional dishonesty or deceit which directly leads to the loss of the money or property.

Losses not Covered

The Fund will not reimburse a loss if:

- it was covered by insurance, a bond or another fund;
- it was caused by negligence or malpractice; or
- it was a bad business loss such as a failed investment.

The Fund also does not cover "interest," "incidental or consequential losses" or "expenses" caused by the attorney. Examples of incidental or consequential losses would include fees applicant paid to another attorney or damages caused by malpractice, negligence or incompetence.

Financial Picture

To have a complete picture of the Fund's fiscal health, it is important not only to see what money is on hand and how much has been actually paid out, but to also know how much is expected to be paid on pending cases. This anticipated payout, or accrued liability, is calculated by multiplying the total dollar amount of the pending cases times an estimated claims payable ratio. The claims payable ratio is based upon how much the Fund has historically paid for every dollar claimed. For example, if the Fund has historically paid \$.30 for every \$1 claimed, then the claims payable ratio is 30 percent.

The claims payable ratio used by the Fund is based upon a 24-month rolling average. The accrued liability changes, not only with changes in the claims payable ratio, but also as the total dollar amount of outstanding applications changes.

Balance Sheet

The balance sheet shows the Fund's assets and liabilities as of December 31, 2007.

Fund assets are maintained in cash and cash equivalents.

Current liabilities include estimated awards ultimately to be paid on applications which are pending as of December 31 plus next year's dues payments received early - for example, 2007 dues received in 2006.

The Fund balance or deficit is simply the difference between Fund assets and accrued liabilities.

Statement Of Revenues, Expenses And Changes In Fund Balance

Total revenues consist of members' dues, interest income and other revenues such as contributions.

Expenses include awards paid, accrued liabilities and administrative expenses. Awards constitute the major element. Off-set against this expense are any monies recovered from the bar's collection activities. This is reflected as "Awards Reimbursements or Recovery."

The Estimated Decrease/(Increase) in Awards Payable Liability is an adjustment made at the end of the year because of a change in the accrued liability.

"Thank you for a program that was very helpful to us."

(Quote from Applicant 2007)

"I want to thank you for renewing my faith in the legal justice system. I am grateful for the professional and personal demeanor given by all who worked with me, from the State Bar investigators to your office."

(Quote from Applicant 2007)

2005 - 2007 BALANCE SHEET STATEMENTS

	AUDITED 12/31/05	AUDITED 12/31/06	UNAUDITED 12/31/07
ASSETS:			
Cash	7,661,596	7,708,941	9,464,048
LIABILITIES & FUND BALANCES:			
Current liabilities	6,181,698	5,383,348	6,473,159
Net Assets	1,479,898	2,325,593	2,990,889
Total liabilities & Fund balances			
	7,661,596	7,708,941	9,464,048

2005 - 2007 STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND BALANCES

	AUDITED 12/31/05	AUDITED 12/31/06	UNAUDITED 12/31/07
REVENUES:			
Membership dues	4,888,776	6,349,590	6,536,140
Investment Income	248,296	427,548	529,984
Other/Miscellaneous Revenues	-	5,103	-
TOTAL REVENUES	5,137,072	6,782,241	7,066,124
EXPENSES:			
Awards Paid/Accrued	4,770,392	4,836,217	5,289,156
Less: Awards Reimbursements or Recovery	(509,061)	(575,041)	(539,728)
CSF Claims Collection Exp.	16,592	9,287	19,375
Total	4,277,923	4,270,463	4,768,803
Administration	1,608,706	1,666,082	1,632,026
TOTAL EXPENSES	5,886,629	5,936,545	6,400,829
EXCESS (DEFICIT) OF REVENUES OVER EXPENSES			
	(749,557)	845,696	665,295
Estimated Decrease / (Increase) in Awards Payable Liability			
	(183,531)	446,712	(908,046)
Net Assets, as of year-end			
	1,479,898	2,325,593	2,990,889

CLAIMS ACTIVITY 1999 - 2007

Nine-year Comparison

	# of Claims	1999 Amount	2000 Claims Amount	2001 Claims Amount	2002 Claims Amount	2003 Claims Amount	2004 Claims Amount	2005 Claims Amount	2006 Claims Amount	2007 Claims Amount
Claims outstanding, beg. of year	913	\$12,270,996	758 \$10,345,650	708 \$8,803,264	751 \$9,517,404	770 10,157,007	759 8,548,576	858 9,956,622	787 10,396,199	797 9,579,525
Prior year's outstdg. claim adj. inc.	1	101,840	(4) (10,043)	(2) 110,553	5 \$29,491	(2) 55,611	(13) 109,900	(3) 90,040	(2) 241,984	- 69,048
New claims	611	6,780,932	1,049 10,929,128	1,114 11,900,739	1,300 14,166,217	1,200 12,221,905	1,321 13,681,482	1,318 11,558,645	1,314 10,916,591	1,013 12,927,446
TOTAL CLAIMS	1,525	\$19,153,768	1,803 \$21,264,735	1,820 \$20,814,556	2,056 \$23,713,112	1,968 22,434,523	2,067 22,339,958	2,173 21,605,307	2,099 21,554,774	1,810 22,576,019
Less: Processed Claims:										
Paid	387	2,811,090	595 3,673,850	609 4,435,212	782 6,597,057	701 5,859,620	746 5,681,455	982 4,648,584	943 5,299,061	607 4,352,110
Rejected	69	1,883,065	132 4,061,716	68 2,903,338	39 2,580,784	39 2,585,959	39 1,701,671	50 2,535,698	24 1,799,629	42 2,066,308
Withdrawn	311	4,113,963	368 4,725,923	392 3,958,602	465 4,378,264	469 5,440,368	424 5,000,210	354 4,024,826	335 4,876,599	374 4,346,458
TOTAL PROCESSED CLAIMS	767	\$8,808,118	1,095 \$12,461,489	1,069 \$11,297,152	1,286 13,556,105	1,209 13,885,947	1,209 12,383,336	1,386 11,209,108	1,302 11,975,249	1,023 10,764,876
Claims outstanding, end of year	758	10,345,650	708 8,803,264	751 9,517,404	770 10,157,007	759 8,548,576	858 9,956,622	787 10,396,199	797 9,579,525	787 11,811,143
Claims outstanding inc./(dec.) over beginning balance	(156)	(2,027,186)	(50) (1,542,386)	43 714,140	19 639,603	(11) (1,608,431)	99 1,408,046	(71) 439,577	10 (816,674)	(10) 2,231,618
Claims payout ratio		31.76%	30.20%	33.75%	44.20%	45.26%	43.88%	43.79%	42.86%	42.45%
Est. claims Fab at payout ratio		\$3,285,778	\$2,658,586	\$3,212,124	\$4,489,397	\$3,869,086	4,368,966	4,552,496	4,105,784	5,013,830
NET ASSETS (end of year)		\$6,617,008	\$8,981,524	\$9,022,435	\$5,656,285	\$4,303,609	2,229,455	1,479,897	2,325,593	2,990,889
NET ASSETS (end of year, cash-basis)		\$9,902,786	\$11,640,110	\$12,234,559	\$10,145,682	8,172,695	6,598,421	6,032,393	6,431,377	8,004,719

Applications Paid by Category

In 2007, the Fund paid out \$4,352,110 on 607 awards.

The largest number of applications paid was in the "unearned fees" category (60.3%). The second largest category by size was "misappropriation" (38.7%) with "loans" and "investments" representing only a few of the applications paid.

Number of Applications Paid by Category in 2007 Total: 607

Unearned Fees	366
Misappropriation	235
Loans	3
Investments	0

5-Year Summary of Applications Paid

2007	607
2006	943
2005	982
2004	746
2003	701

"You have restored my faith in this government's justice system, and for that I thank you many times"
(Quote from Applicant 2007)

Applications Closed

The 1,023 applications "closed" in 2007 include those that are paid, rejected and withdrawn.

5-Year Summary of Applications Closed

2007	1023
2006	1302
2005	1386
2004	1209
2003	1209

"You have given me much more than money by your actions. You gave me some justice."

(Quote from Applicant 2007)

Dollars Paid by Category

In 2007, "misappropriation" cases represented the largest dollar amount of applications paid. \$2,269,119 or approximately 52 percent, of all dollars paid out were in the "misappropriation" category. "Unearned fees" cases represented approximately 45 percent of all dollars paid out with "loans" and "investments" representing a few percent of the total payouts.

Dollars Paid by Category in 2007 Total: \$4,352,110

Misappropriation	\$2,269,119
Unearned Fees	\$1,967,923
Investments	\$0
Loans	\$115,068

5-Year Summary of Applications Paid in Dollars

2007	\$4,352,110
2006	\$5,299,061
2005	\$4,648,584
2004	\$5,681,455
2003	\$5,859,620

"We commend you and congratulate your offices for the morals being set forth"
(Quote from Applicant 2007)

Applications Pending

The year 2007 closed with 787 applications pending, representing \$11,811,143 in reported losses.

5-Year Summary of Applications Pending at Year's End

2007	787
2006	797
2005	787
2004	858
2003	759

"My faith in the integrity of the legal system has been reaffirmed by your action."

(Quote from Applicant 2007)

Commission Members



Julius I. Davis, a public member, is a retired Los Angeles Police Department Assistant Chief. He was appointed in December 2004 and serves as Chair for 2007-2008. His term expires in September 2008.



Donna C. Riegel, an attorney member, is currently a sole practitioner in Pasadena with extensive and varied civil litigation experience. She has been a volunteer temporary judge with the Los Angeles County Superior Courts. She was appointed in October 2004 and serves as Vice-Chair for 2007-2008. Her term expires in September 2008.



Richard C. Henderson, an attorney member, is currently a sole practitioner in Fresno. He was appointed in September 2007. His term expires in September 2010.



Joyce L. Hurley, a public member, is a paralegal in a private legal firm in Los Angeles. She was appointed in September 2005. Her term expires in September 2008.



Daniel L. Nelson, an attorney member, is currently a managing partner in a personal injury litigation firm and is involved in a number of volunteer activities. He was appointed in September 2005. His term expires in September 2008.



Earl Paysinger, a public member, is currently Assistant Chief in the Los Angeles Police Department. He has served in a variety of command assignments and is currently the Director of Operations for the LAPD. He was appointed in October 2006. His term expires in September 2009.



David K. Willingham, an attorney member, recently joined the firm of Caldwell, Leslie & Proctor, PC. He was formerly Deputy Chief of the Major Frauds Section in the U.S. Attorneys Office in the Central District of California. He was appointed in September 2005. His term expires in September 2008.

"I just wanted you to know how deeply I appreciate all your efforts."

(Quote from Applicant 2007)

"Your Client Security Fund has helped to restore my faith in our judicial system"

(Quote from Applicant 2007)

"I would like to say thank you for your assistance. You have been a great deal of help."

(Quote from Applicant 2007)

Decision Making

Policy oversight of the Client Security Fund is a joint responsibility of the Board of Governors and the Client Security Fund Commission.

The Board monitors the Fund through its: appointment of seven commissioners; approval of recommended changes and additions to the Rules of Procedure; consideration and approval of the Fund's annual administrative budget; and power to seek legislative authority to increase the lawyer's fees that support the Fund.

The Board exercises its authority as an entity and through its Regulation, Admissions, and Discipline Oversight Committee (RAD).

Of the seven volunteer members who comprise the Commission, no more than four of them may be lawyers. They are assisted by a professional staff of 9 who screen, analyze, investigate and present cases to the Commission. Staff is subject to Management oversight and reports to Scott J. Drexel, the Chief Trial Counsel for the State Bar's discipline system.

Among the Commission's key functions are:

- determining applications made to the Fund after a written and oral presentation of the matter by CSF staff and, occasionally, after hearing held before the Commission;
- recommending to the Board of Governors necessary staffing levels to carry out the Fund's business in a professional, timely fashion;
- taking steps to increase the efficiency and timeliness with which the Commission and staff process applications;
- monitoring the Fund balance and recommending to the Board of Governors necessary fee increases to guarantee its continued solvency;
- interpreting the Rules of Procedure through policy statements and recommending necessary amendments and additions; and
- providing for the efficient inner workings of the Commission itself.



THE STATE BAR OF CALIFORNIA

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